

REPORT OF EXAMINATION
OF THE
KAISER PERMANENTE INSURANCE COMPANY
AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed June 17, 2005

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San Francisco, California
March 11, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

KAISER PERMANENTE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at One Kaiser Plaza, Suite 13L, Oakland, California 94612.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions,

an evaluation of assets, and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

In addition to items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas which require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

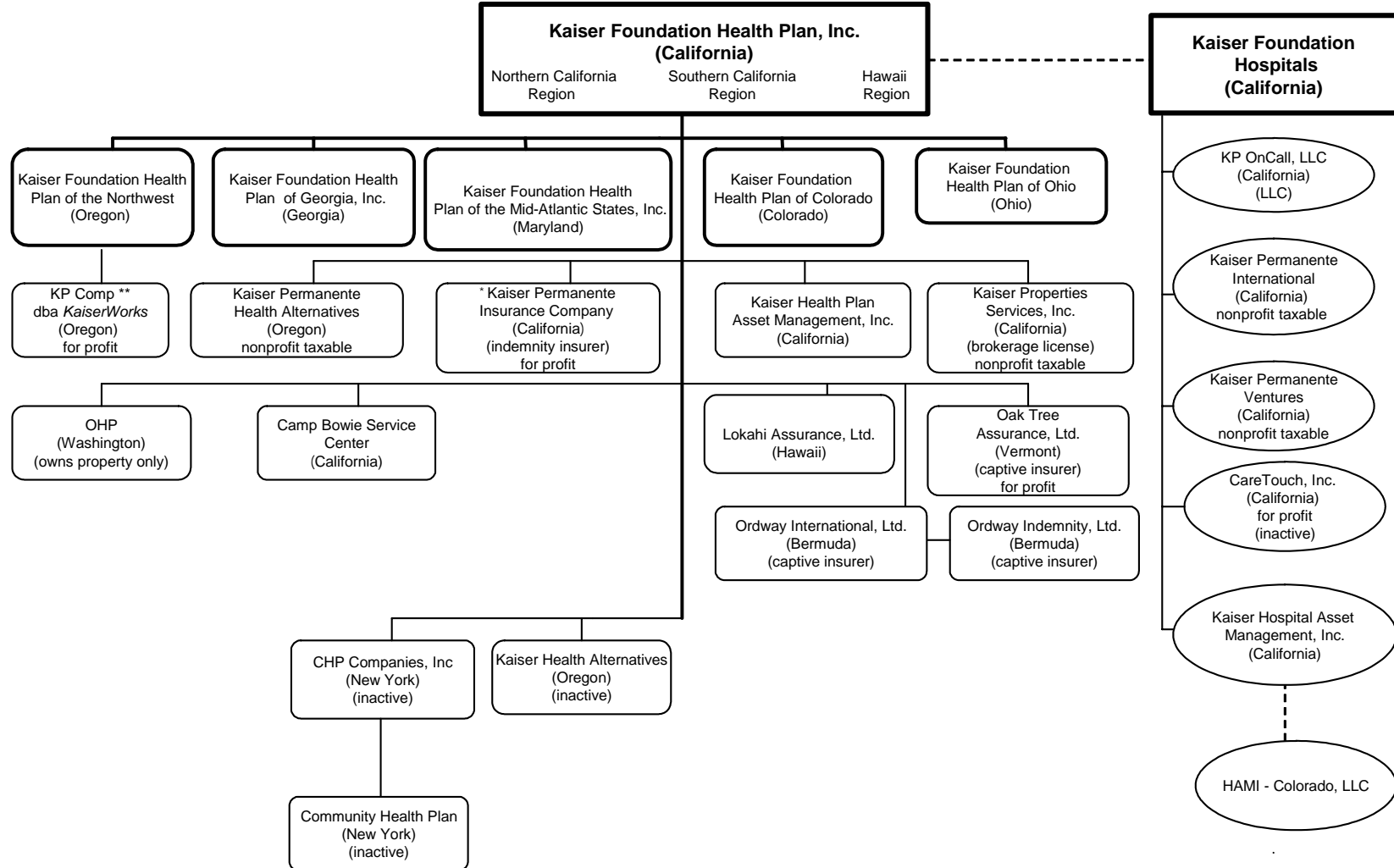
On December 31, 2001, the Company sold 25,000 shares of redeemable preferred stock with par value of \$80 to its parent, Kaiser Foundation Health Plan, Inc., for \$400 a share. As the result of this transaction (authorized by California Department of Insurance's Securities Permit No. SF-2035), the Company's paid-in capital and contributed surplus increased by \$2 million and \$8 million, respectively. The Company obtained the additional capital and surplus to enable it to write more business. The permit states that this redeemable preferred stock may not be redeemed without the Commissioner's prior written consent.

The Company during the period of this examination did not pay any dividends to its parent, Kaiser Foundation Health Plan, Inc.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Kaiser Foundation Health Plan, Inc. (KFHP) is the ultimate controlling entity. KFHP owns 50% of the voting stock of the Company. The remaining 50% of the Company's voting stock is owned by eight independent Permanente Medical Groups. An organizational chart follows:

KAISER FOUNDATION HEALTH PLAN, INC.
SUBSIDIARIES AND AFFILIATED CORPORATIONS



* Kaiser Foundation Health Plan, Inc., owns 50% of the voting stock of the Company. The remainder of the Company's stock is owned by the Permanente Medical Groups
 ** Kaiser Foundation Health Plan of the Northwest owns 50% of the voting stock of KP Comp. The remainder of KP Comp stock is owned by Northwest Permanente, P.C. All ownership is 100% except those stated above.

The management of the Company is vested in a six-member board of directors. Members of the board of directors and principal officers serving on December 31, 2003 (and subsequent changes) were as follow:

Board of Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gerard C. Bajada Oakland, California	Vice President The Permanente Medical Group, Inc.
Francis J. Crosson, M.D. Palo Alto, California	Executive Director The Permanente Medical Group, Inc.
Irwin P. Goldstein, M.D. Woodland Hills, California	Associate Medical Director Southern California Permanente Medical Group
Mitchell J. Goodstein Oakland, California	Senior Vice President Kaiser Foundation Health Plan, Inc.
Jack H. Hudes* La Canada, California	Vice President Kaiser Foundation Health Plan, Inc.
George P. Wilson** Atlanta, Georgia	Vice President Kaiser Foundation Health Plan of Georgia

* replaced by James C. Lugannani on February 25, 2004. James C. Lugannani resigned on February 22, 2005; the board will nominate a replacement in April, 2005

** replaced by Wade J. Overgaard on April 5, 2004

Principal Officers

<u>Name</u>	<u>Title</u>
Theodore E. Wise	President
Robert E. Briggs***	Senior Vice President and Chief Financial Officer
Arthur M. Southam, MD	Senior Vice President
Thomas R. Meier	Vice President and Treasurer
Victoria B. Zatkin	Vice President and Secretary
George C. Kitzmiller	Director of Operations

Principal Officers (continued)

<u>Name</u>	<u>Title</u>
James P. Turner	Actuary
Kelly J. Walsh	Controller

***resigned on February, 22, 2005; position currently remains vacant

Administrative and Management Services Agreements

The Company operates under a management agreement with Kaiser Foundation Health Plan, Inc. (KFHP), the Company's parent. KFHP provides various services to the Company including actuarial, accounting, marketing, investment, administrative, financial, legal, data processing, computer programming, human resources and other management services. Under the terms of the agreement, the Company agrees to pay KFHP for the actual cost of these services.

The Company filed with the California Department of Insurance (CDI) an administrative services agreement with an affiliate, Care Partners Network Management, LLC, pursuant to California Insurance Code Section 1215.5 (b)(4). This agreement was filed with the CDI on September 21, 2004. The effective date of this agreement was October 1, 2004. This agreement remains under review by the CDI pending the submission of additional information that was requested by the CDI from the Company.

Joint Administration Agreements

The Company and KFHP agree to pair KFHP's prepaid health care programs with the Company's indemnity products for purposes of joint marketing and administration. Both companies' health benefit programs are combined to create various health care products. The captioned agreements are between the Company and KFHP's affiliated health plans in Northern California, Southern California, Colorado, Georgia, Hawaii, Kansas, Mid-Atlantic States (Maryland, Virginia and District of Columbia), and Ohio. In these agreements, the affiliated health plans agree to provide the following services to the Company including marketing, advertising, enrollment, underwriting, pricing, utilization management, billing, collections and

claims adjudication in some circumstances. Aside from the above, the Georgia affiliated health plan (KFHP-Georgia) also provides claims handling services to the Company. The fees paid to the affiliates range from 1.5% to 6.5% of premiums depending on costs and services performed. It was noted that the compensation clauses in these agreements do not specify the basis on which the affiliates should be reimbursed for the services rendered. It is recommended that the Company amend the agreements in order to specify the basis on which the affiliates are to be reimbursed. In addition, it was noted the Company has not maintained adequate records to support that the amounts paid to the affiliates are fair and reasonable in compliance with CIC Section 1215.5(a). It is recommended that the Company take corrective action on this matter.

On September 9, 2003, the Company filed with the CDI a joint marketing and administration agreement with its affiliate, KFHP-Georgia. This agreement had an effective date of March 1, 2003. On April 1, 2004, the Company filed with the CDI a similar joint marketing and administration agreement with its affiliate, Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. This agreement had an effective date of November 1, 2003. The filings currently remain under review by the CDI pending the submission of additional information that was requested by the CDI from the Company.

Service Agreements

The Company has a service agreement with Delta Dental Plan of California (Delta). Pursuant to the agreement, Delta agrees to process and pay all of the Company's dental claims. Claims are paid from funds provided by Delta and are later reimbursed by the Company.

The Company has a master services agreement with Perot Systems Healthcare Services, LLC (Perot). Pursuant to the agreement, Perot agrees to provide medical claims processing services for the Company in California, Hawaii, Georgia, and Mid-Atlantic States (Virginia, Maryland, and Washington D.C.).

The Company has a service agreement with North American Benefits Network (NABN), wherein, NABN agrees to provide medical claims processing services to the Company in Ohio.

The Company has an agreement with CCN Managed Care, Inc. (CCN), formerly Community Care Network, Inc., to utilize the health care provider networks developed by CCN for benefits covered under the Company's group health insurance policies. CCN has developed health care provider networks by entering into contracts with various hospitals and other health care providers in various states.

The Company also has an agreement with MedImpact Healthcare System Inc. (MedImpact) in which MedImpact agrees to process and pay all prescription claims for the Company.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2003, the Company was licensed to transact business in the states of California, Colorado, Georgia, Hawaii, Kansas, Maryland, Missouri, Ohio, Oregon, South Carolina, Virginia, Washington, and the District of Columbia. Direct premiums written in 2003 totaled \$82,480,213, of which California accounted for 74.0%, Colorado 4.2%, Hawaii 5.7%, Maryland 8.4%, Ohio 4.7%, and the remaining states 3.0%. Of the \$82,480,213 in direct premiums written, 58% or \$47,772,870, represented dental indemnity business.

The Company jointly markets its indemnity health and dental products alongside Kaiser Foundation Health Plan, Inc.'s (KFHP) prepaid health care plans. It uses the same sales force employed by KFHP. The Company offers point-of-service, preferred provider organization option, out-of-area health, and dental coverages. The point-of-service product is a single benefit product with two elements: health care services through prepaid group coverage to be provided by KFHP and indemnity health care coverage through a policy issued by the Company. The preferred provider organization option offers the members, within an employer group, a choice of either one of the following: health care services through prepaid group practice coverage to be provided by KFHP, or indemnity health care coverage through an insurance policy issued by the Company. The Company's out-of-area products consist of indemnity health care coverage that provides coverage to subscribers who do not live in a KFHP's service area, but live in the United States.

REINSURANCE

Assumed

The Company has not assumed any business since February, 2003 and has no assumed reinsurance treaty in-force as of December 31, 2003.

Ceded

The Company had a 50% quota share agreement with Allianz Life Insurance Company of North America (Allianz), an admitted insurer in California, which covers its accident and health business prior to December 31, 2001. On December 31, 2001, the Company terminated this agreement with Allianz and has not ceded any business since this date.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. The review encompassed significant service providers used by the Company to process its data. Based on the review, the following recommendations were developed:

- (1) It is recommended that the Company provide responses to the examination information systems questionnaire (ISQ) for all financially significant information systems in the future in accordance with the ISQ guidelines (including those significant applications processed by the Company's service providers).
- (2) It is recommended that the Company request its service providers to use the NAIC ISQ as a guide in establishing the scope of the SAS 70 audit and the scope include specific testing of the Company's applications, disaster recovery, and backup storage.
- (3) It is recommended that the Company follow-up with its service providers and service auditors to ensure that corrective actions have been taken with respect to exceptions noted in the SAS 70 reports.

FINANCIAL STATEMENTS

The financial statements prepared for this report include the following:

Statement of Financial Condition as of December 31, 2003

Summary of Operations and Capital and Surplus Account for the Year Ended
December 31, 2003

Reconciliation of Capital and Surplus from December 31, 2000 through
December 31, 2003

Statement of Financial Condition
as of December 31, 2003

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$41,410,796	\$41,410,796	(1)
Cash and short-term investments	18,997,000	18,997,000	
Investment income due and accrued	259,125	259,125	
Uncollected premiums	4,316,445	4,316,445	
Net deferred tax assets	<u>239,045</u>	<u>239,045</u>	
Total assets	<u>\$65,222,411</u>	<u>\$65,222,411</u>	
<u>Liabilities, Surplus and Other Funds</u>			
Contract claims: accident and health		\$20,363,271	(2)
General expenses due or accrued		4,046,640	
Taxes, licenses and fees due or accrued		160,459	
Current federal income tax		1,096,437	
Miscellaneous liabilities:			
Payable to parent, subsidiaries and affiliates		5,470,559	
Aggregate write-ins for liabilities:			
Escheat liabilities		57,497	(3)
Miscellaneous payable		<u>1,932</u>	
Total liabilities		31,196,795	
Common capital stock	\$ 48,000		
Preferred capital stock	4,000,000		
Gross paid-in and contributed surplus	16,000,000		
Unassigned funds (surplus)	<u>13,977,616</u>		
Capital and surplus		<u>34,025,616</u>	
Total liabilities, surplus and other funds		<u>\$65,222,411</u>	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2003

Summary of Operations

Premiums for accident and health contracts	\$82,839,469
Net investment income	1,006,665
Miscellaneous income	<u>12,590</u>
Total	<u>83,858,724</u>
Benefits under accident and health contracts	60,167,981
Commissions on premiums	680,117
Commissions and expense allowances on reinsurance assumed	139,516
General insurance expenses	13,881,601
Insurance taxes, licenses and fees, excluding federal income taxes	<u>2,123,683</u>
Total	<u>76,992,898</u>
Net gain from operations before federal income taxes	<u>6,865,826</u>
Federal income taxes incurred	<u>2,384,604</u>
Net income	<u>\$ 4,481,222</u>

Capital and Surplus Account

Capital and surplus, December 31, 2002	\$29,494,620
Net income	\$4,481,222
Change in net deferred income tax	<u>49,774</u>
Net change in capital and surplus for the year	<u>4,530,996</u>
Capital and surplus, December 31, 2003	<u>\$34,025,616</u>

Reconciliation of Capital and Surplus
from December 31, 2000 through December 31, 2003

Capital and surplus, December 31, 2000, per Examination			\$12,306,636
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$11,247,682	\$	
Change in net deferred income tax		26,729	
Change in nonadmitted assets	232,253		
Cumulative effect of changes in Accounting principles	265,774		
Capital changes: Paid-in	2,000,000		
Surplus changes: Paid-in	<u>8,000,000</u>		
Total gains and losses in surplus	<u>\$21,745,709</u>	<u>\$ 26,729</u>	
Net increase in surplus			<u>21,718,980</u>
Capital and surplus, December 31, 2003, per Examination			<u>\$34,025,616</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

As of the end of last examination period, the Company's securities were on deposit with Bank of New York Trust Company of California under a custodial agreement approved by the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Sections 1104.9 (c) and (d). However, in May, 2002, the Company transferred its securities to Bankers Trust Company of California under a master and collective trust agreement between Kaiser Foundation Health Plan, Inc. and Bankers Trust Company of California. This agreement did not comply with the aforementioned CIC Sections. On April 2, 2004, the Company entered into a new custodial agreement with State Street Bank using an agreement form pre-approved by the CDI. The Company filed the new custodial agreement with the CDI on November 3, 2004. It is recommended that the Company maintain its securities in compliance with CIC Sections 1104.9 (c) and (d) at all times.

(2) Contract Claims: Accident and Health

The Company's policy and contract claims reserve was tested using a 7-month development of losses. The development indicated that the Company's claims reserve as of December 31, 2003 was reasonably stated.

(3) Escheat Liabilities

The captioned account of \$57,497 represents checks that have been outstanding for more than six months as of June 30, 2003, on an inactive claims account. On three other claims accounts, the Company has instructed the bank to issue stop-payments on those checks that have been outstanding in excess of 90 days. The Company then reverses these checks back into income by debiting cash and crediting claims paid which may not be a proper entry as not all escheat/claim liabilities have been extinguished in all cases. The lists of those checks are then sent to the Company's third-party administrators (TPAs) for reissue. Although some of those checks are

reissued by the TPAs, it is recommended that the Company add oversight controls and documentation to ensure that all checks are reissued timely and to follow-up with the TPAs on checks that are inadvertently overlooked in the process. It is also recommended that any checks that are not reissued and remain unclaimed be reclassified into a liability account pending escheat to the appropriate jurisdiction and not taken into income.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Joint Administration Agreements (Page 5): It is recommended that the Company amend its Joint Administration Agreements in order to specify the basis on which the affiliates are to be reimbursed. It is also recommended that the Company maintained adequate records to support that the amounts paid to the affiliates are fair and reasonable in compliance with California Insurance Code (CIC) Section 1215.5(a).

Accounts and Records - Information Systems Controls (Page 8): It is recommended that the Company provide adequate responses to the examination information systems questionnaire (ISQ), request its service providers to use the NAIC ISQ as a guide for the SAS 70 audits and follow-up with its service providers with regard to deficiencies noted in the SAS 70 audit reports.

Comments on Financial Statement Items - Bonds (Page 13): It is recommended that the Company maintain its securities in compliance with CIC Sections 1104.9 (c) and (d) at all times.

Comments on Financial Statement Items - Escheat Liabilities (Page 13): It is recommended that the Company add oversight controls and documentation to ensure that all checks are reissued timely and to follow-up with the TPA's on checks that are inadvertently overlooked in the process. It is also recommended that any checks that are not reissued and remain unclaimed be reclassified into a liability account pending escheat to the appropriate jurisdiction and not taken into income.

Previous Report of Examination

Corporate Records (Page 6): It was recommended that the Company strictly comply with California Insurance Code Section 1200 regarding the approval of investments. No violation of the above code section was noted in this examination.

Accounts and Records - Information Systems Controls (Page 8): It was recommended that the Company work with its outside vendors to make appropriate changes to strengthen information systems controls with respect to the processing of the Company's data. It was recommended that the Company amend its agreements with its outside vendors to require that they provide periodic and comprehensive SAS 70 audit reports with respect to their operations. SAS 70 audit reports were provided to the Company by its outside vendors in the period under the current examination.

Accounts and Records - General (Page 9): It was recommended that the Company work with its parent company to establish procedures to strengthen the controls over the maintenance and updating of its records. It appears that the Company still needs improvements in this area; agreements with its parent and affiliates need to be updated.

Comments on Financial Statement Items - Cash and Short-Term Investments (Page 13): It was recommended that the Company follow its established procedures with respect to outstanding checks and unclaimed property. The Company still needs to make improvement in this area; deficiencies were noted in this examination.

Comments on Financial Statement Items - Accident and Health Premiums Due and Unpaid (Page 13): It was recommended that the Company work with its administrator, Health Plan Services (HPS) to streamline the premium reporting in order to make it less complex and easier to follow and audit. It was recommended that the Company direct HPS to change its method of aging the Company's premiums to conform to Statement of Statutory Accounting Principle (SSAP) No. 6. The Company has terminated its contract with HPS. Currently the Company's

affiliates perform the function of premium billing and collection. The affiliates pay the full billing amount to the Company each month. Corrections are made to the list of insured members as soon as the Company is notified by the affiliate. Appropriate adjustments are then made to the billing statement for the following month. As a result, the Company has no aged accounts receivable and no non-admitted amounts to report on its Annual Statement. It appears that the Company does conform to SSAP No. 6.

Comments on Financial Statement Items - General Expenses Due and Accrued (Page 14): It was recommended that the Company report loss adjustment expenses under General Expenses Due and Accrued in accordance with the National Association of Insurance Commissioners' Annual Statement Instructions for Life and Accident and Health. It was recommended that the Company research the unidentified items in its general expense account to determine if actual liabilities exist so that they can appropriately be cleared from the Company's books. The Company has taken corrective actions with respect to the above recommendations.

It was recommended that the Company continue to request its outside counsel to submit billings so that the long-standing liability can appropriately be cleared from its books. It was also recommended that the Company request timely billings from its legal counsel on all future services rendered so that the incurred liability can be discharged in a timely manner. It appears that the Company has made the appropriate requests to its law firm; however, it still has not received billings for services rendered as of the date of this report. It is recommended that the Company take the appropriate actions to get this issue resolved in the near future.

ACKNOWLEDGEMENT

The undersigned would like to thank the Company's officers and employees for their cooperation and assistance during the course of this examination.

Respectfully submitted,

Kelvin Ko, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California